LESSON TWO: SUPPLY SERVICES

Objective: To learn the basics of how a cooperative can provide a supply service for its members to purchase the inputs they need, and how this works as an economic enterprise.

The Valda Co-operative was quite successful in its efforts to market the members' produce. After some years, it was suggested that they should also start to offer the members another service: supplying some “farm inputs”.

How it works:

After conducting some surveys and the necessary planning, it was decided that the co-operative should buy fertilisers and insecticides from suppliers. These should then be re-sold to the members of the co-operative.

Because the co-operative was buying supplies for all its members, it could buy in bulk, at a cheaper rate. In fact, it could buy at the same prices paid by private traders. But a private trader would tack his own profit onto this price before selling to the farmers. The co-operative, on the other hand, is made up of farmers, and any profit (surplus) it makes on the business belongs to them.

In the same way that it cost the Valda Co-operative money to provide a marketing service to its members, so it would also cost money to provide a supply service. The management of the co-operative had to plan the new business carefully. In particular they had to think about the capital they would need to raise, and about how they would cover the extra running costs.

Capital

To start a supply service the Valda Co-operative needed more capital. First, they had to extend the warehouse to make room for a stock of farm supplies and second, they had to purchase the farm supplies.
The co-operative was able to raise a total of T$22,000.

Part of this money came from resources which had been built up by the marketing business over a number of years. The rest of the money was provided by a bank loan.

T$3,500 was used for the extension to the warehouse. The members of the cooperative did a lot of the work themselves, which kept the cost down.

Most of the remaining T$18,500 was used to buy a stock of fertilisers and insecticides.

These supplies were sold to the members. The sales provided money again to buy new stock. Trading continues....

Running costs

Suppose that the co-operative buys a drum of insecticide at T$15, including the cost for delivery to the co-operative. This is what we call the COST PRICE. Suppose also that the co-operative sells the drum to a member at the same price, T$15. In this way the co-operative would get back its working capital and be able to buy a new drum of insecticide. The business can go on....

But there are also running costs involved in providing a supply service. The marketing business paid its costs by taking a commission on the sales of maize. The supply business can do something similar by adding a MARK-UP to the cost price and in that way "earn a MARGIN" on the sales to cover the running costs.

For instance, if the co-operative adds a mark-up of T$2 on the drum of insecticide, it can sell it at T$17.
The Valda Co-operative worked out that the total running costs for the supply services would be T$1,800. Thus, they must have a margin of $1,800 on the sales of supplies just to cover the running costs.

This equation shows how the Valda Co-operative planned its supply business:

\[
\begin{align*}
\text{T$ 18,000} & \quad \text{EXPECTED SALES} \\
\text{T$ 16,200} & \quad \text{COST OF SUPPLIES} \\
\text{T$ 1,800} & \quad \text{MARGIN}
\end{align*}
\]

The margin can also be expressed as a percentage of the sales. Valda's margin was T$1,800 out of the total sales of T$18,000. That is a margin of 10%.

\[
\frac{T$ 1,800}{T$ 18,000} \times 100 = 10\%
\]

The management decided to have a bit lower margin on fertilisers, but a higher one on insecticides. However, on average, the margin was 10%, enough to cover the running costs.

Unfortunately, something nearly always happens to reduce the expected margin. Let us take an example:

The Valda Co-operative bought 100 bags of fertiliser. The cost price was T$15 each. The mark-up was T$1.30 on each bag, so a margin of 100 x T$1.30 = T$130 was expected for the whole lot.

But two bags were left behind when the truck was loaded. Nobody noticed it. This meant that the income from the sales of this lot was reduced. We say that they had a "leakage" of T$32.60.

Expected sales: 100 x T$16.30 = T$ 1,630.00
Actual sales: 98 x T$16.30 = T$ 1,597.40
Leakage: T$ 32.60

Very often, thanks to leakage and other losses, the actual margin is lower than the expected margin. It is important for a co-operative manager and his committee to remember this when they decide on their trade margins.

Surplus

We remember from Lesson 1 that the Valda Co-operative made a surplus on their marketing business - there was some money left over when all expenses had been paid. It is equally important that the supply business give a surplus.

The Valda Co-operative had the following result from their supply services one year:

\[
\begin{align*}
\text{SALES OF SUPPLIES} & \quad T$ 26,000 \\
\text{COST OF SUPPLIES} & \quad - 23,400 \\
\text{GROSS SURPLUS (MARGIN)} & \quad T$ 2,600
\end{align*}
\]
What is left when the co-operative has paid the suppliers for all the goods is the margin, or GROSS SURPLUS. And we know what the gross surplus should be used for: to pay the running costs.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GROSS SURPLUS</td>
<td>T$ 2,600</td>
</tr>
<tr>
<td>RUNNING COSTS</td>
<td>- 1,800</td>
</tr>
<tr>
<td>NET SURPLUS</td>
<td>T$ 800</td>
</tr>
</tbody>
</table>

The amount of money left to the co-operative and its members after paying all the costs is the NET SURPLUS. In Lesson 3 we will discuss what the net surplus should be used for.

You have now examined some very basic principles affecting co-operative business. Everyone - members, committee and staff - should have a good understanding of these matters.

The manager, whose job it is to run the day-to-day business of the co-operative, must have a more thorough understanding of these commercial terms as well as the relationships between them.

You will find a summary of the basic principles in the document list of this study guide, which you can download and print as a reminder and quick reference sheet.

Here are some questions for you to consider.

1. Explain the basic functions of a supply cooperative.

Now think about your own cooperative and answer these questions.

2. How much capital did your own cooperative start with?
3. How was the money raised?
4. What fixed assets does your cooperative have? Make a list and put an approximate value next to each item.
5. How much working capital does your own cooperative have?
6. How high were the running costs of your own cooperative last year?
7. How much commission (in % terms) did your cooperative deduct from the sales of produce last year?
8. What was the margin (in % terms) on the sales of farm supplies?